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C O N F I D E N T I A L SECTION 01 OF 03 MOSCOW 000199

SIPDIS

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TAGS: [EPET](#) [ENRG](#) [ECON](#) [PREL](#) [RS](#)  
SUBJECT: TRANSNEFT HEAD TELLS AMBASSADOR COMPANY BUILDING  
NEW OIL EXPORT PIPELINES AS GOVERNMENT HAS DIRECTED

REF: A. 08 MOSCOW 3591  
[1](#)B. 08 MOSCOW 3380  
[1](#)C. 08 MOSCOW 2053

Classified By: Ambassador John R. Beyrle for Reasons 1.4 (b/d)

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SUMMARY  
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[1](#)1. (SBU) Transneft President Nikolai Tokarev told the Ambassador January 27 the company is moving forward on its various major pipeline projects as "they are needed to handle new oil supplies" and "because the government has directed them." Tokarev said the company is getting the funding it needs for the projects largely from state-owned banks, but complained about banks being tight with financing. He blamed the reduction of oil supplies to the Czech Republic in July (ref C) on non-transparent oil trading companies (ref B). Tokarev's descriptions of Transneft's projects reinforce the company's reputation as a politically-driven, uneconomical Russian state-owned enterprise. End summary.

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NEW OIL PIPELINES NEEDED, DIRECTED BY GOVERNMENT  
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[1](#)2. (SBU) Tokarev told the Ambassador in a January 27 meeting that the 100% government-owned company controls 50 thousand kms of oil pipelines, and, with its recent acquisition of Transnefteprodukt, another 20 thousand kms of oil product pipelines. Tokarev said the company has four main pipeline projects under development: the East Siberia-Pacific Ocean (ESPO) pipeline, the Baltic Pipeline System 2 (BPS2), the Burgas-Alexandropoulis pipeline (BAP), and the Caspian Pipeline Consortium (CPC) pipeline.

[1](#)3. (SBU) Tokarev said the first phase of the company's most ambitious project, the ESPO, should be completed by December [1](#)2009. He said, however, progress has been hampered by difficult conditions, including warmer-than-usual winters that result in swampy terrain. The 2,700 km first phase, which will reportedly cost \$14 billion or more when complete, is designed to carry Russian crude to China. Tokarev said phase 2 of the project, a 2,100 km extension to the Pacific Ocean, is planned for completion in 2013.

[1](#)4. (SBU) Responding to the Ambassador's suggestion that some analysts indicate there won't be enough oil to justify phase 2, Tokarev claimed the company already has commitments from

Rosneft, Surgutneftegaz, and TNK-BP, to fill phase 2. He specifically pointed to 62 million tons (mt) of new supplies coming online in the next few years as the source of future supplies for ESPO. However, Tokarev left open the possibility that phase 2 could be delayed, acknowledging that future supplies can be hard to predict and that many oil companies are shutting down and delaying projects due to the plunge in oil prices and the financial crisis. (Note: In addition, new supplies will, at best, replace declining production from older fields. End note.)

15. (SBU) Tokarev used the same 62 mt in new supplies to justify the need for BPS2. He said the GOR recently approved the company's plans to build the pipeline (which some analysts estimate could cost \$5 billion or more). The project is designed to bypass transit states and deliver oil directly to Russian port of Ust-Luga (near St. Petersburg) on the Baltic sea, from which it would be shipped by tanker. Tokarev pointed to potential problems with Ukraine as a transit state (technical complications related to flows along the Odessa-Brody pipeline, the recent gas crisis, Ukraine's "unreliability" as a partner) as further justification for BPS2.

16. (SBU) Tokarev said that Russian and Kazakh officials are engaged in ongoing negotiations to bring more Kazakh oil to Russia for export to other markets, including through ESPO and BPS2. He emphasized Russia's need and desire for "alternatives" in its export routes. When pressed on the issue of whether BPS2 would be economically justified if relations with Ukraine were not an issue, Tokarev said the

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pipeline will be built because the government has so "directed."

17. (SBU) Tokarev also justified the BAP project, noting that with the Bosphorous straits woefully congested -- "all tankers other than U.S. ones are delayed at least 3 days" -- a bypass was needed. According to Tokarev, "concrete" work on BAP construction would begin this year with feasibility studies already contracted to a German firm. He said BAP has been on the drawing board for a decade and does not depend on CPC expansion (ref A). Tokarev added, however, that "if" CPC expansion moves forward, BAP could use CPC crude. Quickly qualifying his use of the word "if," Tokarev said he sees "no problems" with CPC expansion, but that "details" are still being worked out.

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THE IMPACT OF THE FINANCIAL CRISIS  
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18. (SBU) Tokarev said Transneft's projects enjoy government support, given their immediate job-creating effects. He claimed that despite a tough environment in the credit markets, the company had arranged financing for all of its planned capital expenditures in 2009, largely through state-owned banks (i.e. Sberbank, VTB, etc.). Tokarev, however, complained that banks have been tight with credit. He added that the Ministry of Finance is reviewing Transneft's financing needs with regard to BPS2, though he was sure it would approve the funding. Tokarev said Transneft is also seeking financing by issuing 3-5 year notes, but admitted that the success of financing options is difficult to predict in the current environment.

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SUPPLY REDUCTIONS TO THE CZECH REPUBLIC  
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19. (SBU) In response to the Ambassador's query, Tokarev blamed the summer reductions of oil supply to the Czech Republic (ref C) on an oil trading intermediary of unknown off-shore ownership. According to Tokarev, refineries in the Czech Republic do not have contracts with Transneft nor with

Russian oil producers but with oil trading companies (ref B) who were responsible for the diversion of oil supplies. He claimed that Transneft had fulfilled all its oil transport obligations. Tokarev added that Transneft is in talks with its Czech counterpart, Mero, on the creation of a joint company to handle the oil trade between Russia and the Czech Republic, eliminating other oil trading intermediaries.

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BIO NOTE  
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¶10. (C) According to various press reports, Tokarev, whose official bio is blank from 1973 to 1999, is a close friend of PM Putin. He was reportedly Putin's boss in the KGB in East Germany in the 1980s. He reportedly has a similar link to Gennady Timchenko, owner of secretive oil trading company Gunvor (ref B), whose firm controls much of the pipeline trade out of Russia. He was flanked in the meeting by his Deputy, Mikhail Barkov, and his International Affairs Advisor, Oleg Pillipets, both security service alumni.

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COMMENT  
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¶11. (C) Transneft is a prime example of Russia's failed economic model of state-owned "national champions." It is run not by a businessman with industry experience, but by a political insider with an intel background. Many Transneft projects -- including BPS2, ESPO phase 2, and even ESPO phase 1 -- are driven not by economic fundamentals, but by the state's overarching geopolitical goals. The projects are thus not financed by the markets, but, by Tokarev's own admission, by state-owned banks at the government's direction. Given its monopoly status, there is no doubt Transneft will continue to play a vital role in delivering Russian crude to markets. However, its services are more

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likely a drain on the Russian economy than a contributor to growth.  
BEYRLE